THE NEW NEW YORK STATE ESTATE TAX REGIME, A TRAP FOR THE UNWARY PROPOSED WILL LANGUAGE TO SAVE ESTATE TAXES AND OBTAIN DIRECT PECUNIARY BENEFIT FOR BENEFICIARIES (SANTA CLAUSE)

by

PAUL S. FORSTER, ESQ.

and

LAURENCE KEISER, ESQ.

Stern Keiser & Panken LLP
White Plains

The New New York State Estate Tax Regime, A Trap For The Unwary

Proposed Will Language to Save Estate Taxes and Obtain Direct Pecuniary Benefit for Beneficiaries (Santa Clause)

© Paul S. Forster, Esq. and Laurence Keiser, Esq.

Chapter 59 of the Laws of 2014 (Part X) made significant amendments to the New York State estate tax effective for estates of individuals with dates of death on or after April 1, 2014. Prior to these amendments, the New York State estate tax was the maximum amount allowed on the federal estate tax return as a credit for state death taxes.

Among other things pertinent to this article, Chapter 59 increased the New York State estate tax return filing thresholds as follows: effective for decedent's who died on or after April 1, 2014 ($2,062,500), effective April 1, 2015 ($3,125,000), effective April 1, 2016 ($4,187,500), effective April 1, 2017 ($5,250,000), and effective January 1, 2019 (the Federal basic exclusion amount then in effect.) The Federal basic exclusion amount, insofar as presently is known, is $5,450,000 for decedents who die on or after January 1, 2016 and is subject to increase (indexed) thereafter based on inflation.

Under Chapter 59, the estate tax is computed based on the New York taxable estate using the following tax table:

If the New York taxable estate is:	The tax is:
Not over $500,000	3.06% of taxable estate
Over $500,000 but not over $1,000,000	$15,300 plus 5.0% of excess over $500,000
Over $1,000,000 but not over $1,500,000	$40,300 plus 5.5% of excess over $1,000,000
Over $1,500,000 but not over $2,100,000	$67,800 plus 6.5% of excess over $1,500,000
Over $2,100,000 but not over $2,600,000	$106,800 plus 8.0% of excess over $2,100,000
Over $2,600,000 but not over $3,100,000	$146,800 plus 8.8% of excess over $2,600,000
Over $3,100,000 but not over $3,600,000	$190,800 plus 9.6% of excess over $3,100,000
Over $3,600,000 but not over $4,100,000	$238,800 plus 10.4% of excess over $3,600,000
Over $4,100,000 but not over $5,100,000	$290,800 plus 11.2% of excess over $4,100,000
Over $5,100,000 but not over $6,100,000	$402,800 plus 12.0% of excess over $5,100,000
Over $6,100,000 but not over $7,100,000	$522,800 plus 12.8% of excess over $6,100,000
Over $7,100,000 but not over $8,100,000	$650,800 plus 13.6% of excess over $7,100,000
Over $8,100,000 but not over $9,100,000	$786,800 plus 14.4% of excess over $8,100,000
Over $9,100,000 but not over $10,100,000	$930,800 plus 15.2% of excess over $9,100,000
Over $10,100,000	$1,082,800 plus 16.0% of excess over $10,100,000

It widely was believed that under the language of Chapter 59 of the Laws of 2014 (Part X) the tax tables would have expired for individuals with dates of death after March 31, 2015. This specifically was rectified by Chapter 59 of the Laws of 2015 (Part BB) to make the tax tables permanent.

Chapter 59 of the Laws of 2014 (Part X) also provides an applicable credit for certain estates.

As ‘explained’ in New York State Department of Taxation and Finance Technical Memorandum TSB-M-14(6)M, which provides a summary of all of the amendments to the New York State estate tax effective April 1, 2014, which can be

found at the Department's website (www.tax.ny.gov), the applicable credit is allowed against the estate tax when a New York taxable estate (including gifts) is not greater than 105% of the basic exclusion amount. The amount of the credit cannot exceed the tax imposed.

If the New York taxable estate is less than or equal to the basic exclusion amount, the applicable credit amount will be the amount of tax that is computed on the taxable estate. The applicable credit is phased out as the New York taxable estate approaches 105% of the basic exclusion amount.

If the New York taxable estate is greater than the basic exclusion amount but not greater than 105% of the basic exclusion amount, then the applicable credit is equal to the estate tax that would be due on an amount computed by multiplying the basic exclusion amount by one minus a fraction.

The numerator of the fraction equals the New York taxable estate minus the basic exclusion amount, and the denominator equals five percent of the basic exclusion amount. This is very confusing stuff, and requires careful parsing of the language in order to create the correct algebraic equation. Common core it is not.

Pernicious Effect of New Estate Tax Regime

The purpose of this article is to explain the pernicious effect of the new New York State estate tax regime as a trap for the unwary, and to suggest some Will (or trust) language (a Santa Clause) to protect clients and their beneficiaries.

The following is an example of how the 'credit' is applied, and how the Santa Clause language would affect favorably the amounts received by the beneficiaries.

Our example is based upon the estate of a decedent who died between April 1, 2015 and March 31, 2016. The taxable estate in our example is $3,200,000. The applicable credit is available because the taxable estate exceeds the basic exclusion amount ($3,125,000) which applies during that period by an amount ($75,000) that is less than or equal to 5% of the basic exclusion amount ($156,250).

The credit against the tax is equal to the estate tax that would be due on an amount computed by multiplying the basic exclusion amount ($3,125,000) by one (1) minus a fraction. The numerator of the fraction equals the New York taxable estate ($3,200,000) minus the basic exclusion amount ($3,125,000) which equals $75,000. The denominator of the fraction equals five (5) percent of the basic exclusion amount or $156,250 (5% X $3,125,000).

In our example, the credit would be $75,925, calculated as follows: (3,125,000 x (1-75,000/156,250) = 3,125,000 x (1-.48) = 3,125,000 x .52 = 1,625,000. The credit would be the tax on 1,625,000.

Accordingly, the estate tax on $3,200,000, for a decedent dying between 4/1/15 and 3/31/16 would be $124,475, calculated as follows:

Taxable estate	$3,200,000
Tax computed	$200,400
Credit	$75,925
Estate tax due	$124,475

But wait a minute you say. If the taxable estate is $3,200,000 and the tax is $124,475, the net estate distributable to the beneficiaries is only $3,075,525. If the

taxable estate were only $3,125,000 there would be no tax due and the beneficiaries would get $3,125,000. With an estate that is $75,000 ***greater,*** they get $49,475 ***less***. How can this be? It is because the manner in which the credit is calculated phases out the credit in such a way as in our example the 'marginal' rate is 1.66%, or greater than 100%.

During our 4/1/15 to 3/31/16 period the credit phases out between a taxable estate of $3,125,000 and $3,281,250 (3,125,000 x 1.05%), as we have seen, a difference of $156,250. However the estate tax at the upper boundary of the phase-out range is $208,200, as against an increase in the taxable estate of only $156,250, still a marginal rate of 1.33%

But that is not the end of it. It is not until the taxable estate reaches $3,338,717 that an increase in the taxable estate actually results in the beneficiaries getting more money. Put another way, the beneficiaries of a taxable estate of $3,338,717, on which the estate tax is $213,717, end up getting only $3,125,000, which is the same amount that they would get on a taxable estate of $3,125,000 which would be exempt from tax. That means that the beneficiaries get no benefit of any portion of the additional $213,717.

But that is not the worst part of it. Because of the way the credit phases out, on estates between $3,125,001 and $3,338,716, the beneficiaries get ***less*** than $3,125,000, the so-called 'exempt' amount.

For the estates of decedent's dying between April 1, 2016 and March 31, 2017, the 'exempt' amount is $4,187,500. The credit phases out between

$4,187,500 and $4,396,875. It is not until the taxable estate reaches $4,526,014, however, $338,514 more than the ‘exempt’ amount, that an increase in the estate will result in the beneficiaries getting more, and on estates between $4,187,501 and $4,526,013, as the credit phases out the beneficiaries actually get ***less*** than $4,187,500, the so-called ‘exempt’ amount.

Similarly, for the estates of decedent’s dying between April 1, 2017 and December 31, 2018, the ‘exempt’ amount is $5,250,000. The credit phases out between $5,250,000 and $5,512,500. It is not until the taxable estate reaches $5,728,182, however, $478,182 more than the ‘exempt’ amount, that an increase in the estate will result in the beneficiaries getting more, and on estates between $5,250,001 and $5,728,181, as the credit phases out the beneficiaries actually get ***less*** than $5,250,000, the so-called ‘exempt’ amount.

To paraphrase Senator Dirksen, at $213,717, $338,514, and $478,182, in the respective periods, you are talking real money!

Santa Clause

All is not lost, however. It is proposed that the Santa Clause described below be included in all Wills or trusts in which the taxable estate may fall within the respective ranges.

Put simply, the effect of a Santa Clause is to authorize the executor of an estate within the ranges to make a charitable gift of so much of the estate as will reduce the taxable estate to the exempt amount.

A proposed Santa Clause would read as follows:

"In the event my estate is taxable for New York State Estate Tax purposes, then, and in that event, I give, devise, and bequeath to: (choose one of the following three (3) alternatives)

1. particular named charity (ies);
2. my executor hereinafter named to be distributed by him to, between, or among the following named charity (ies);
3. my executor hereinafter named to be distributed by him to, between, or among such charity (ies) distributions to which are eligible to be deducted for estate tax purposes as may be designated by him;

the maximum portion of my estate as will result in a reduction of my net New York State Estate Tax which equals or exceeds the amount so distributed.

Once the taxable estate exceeds the upper bounds described above, $3,338,717, $4,526,014, and $5,728,182, during the pertinent periods, any distributions would exceed the tax imposed, and the Santa Clause would not apply, since there is no credit and the marginal rates applied would be 9.6%, 11.2% and 12%, respectively, which are only fractions of any amounts distributed.

Effect of Use of Santa Clause

Under examples 1, 2 and 3 of the proposed Will (or trust) clause above (Santa Clause) in an estate in which the taxable estate otherwise would be $3,200,000, a gift to charity of $75,000 would save the estate $124,475.

The benefit to the beneficiaries ($49,475) is calculated as follows:

(A) Will as written:

Taxable estate: $3,200,000

estate tax: (124,475)

net distributable: $3,075,525

(B) Will with Santa Clause:

Taxable estate: $3,125,000 ($3,200,000-$75,000)

estate tax: 0

net distributable to non-charitable beneficiaries: $3,125,000

It is hoped that this analysis has shed some light on this complicated subject and provides some helpful guidance to avoid the trap this estate tax regime lays for unsuspecting practitioners.